

DEPARTMENT OF CORPORATIONS*Business Services and Consumer and Investor Protection*

Preston DuFauchard
California Corporations Commissioner
Sacramento, California

INVITATION FOR COMMENTS**CALIFORNIA INVESTMENT ADVISER REGULATIONS****PRO 02/11****BACKGROUND**

The Department of Corporations ("Department") licenses and regulates investment advisers under the Corporate Securities Law of 1968 (Corporations Code Section 25000 et seq., the "Corporate Securities Law"). Under the Corporate Securities Law, it is unlawful for an investment adviser to conduct business without first applying for and securing a certificate.

The Department is considering changes to a regulation that impacts California investment advisers, and in accordance with Government Code Section 11346.45, the Department is seeking comments from interested parties and those who would be subject to the proposed regulations, prior to the Department providing notice of a proposed rulemaking action.

More specifically, the Department is seeking comments on amendments to Section 260.204.9 of Title 10 of the California Code of Regulations.

On July 21, 2010, President Barack Obama signed *The Dodd-Frank Wall Street Reform and Consumer Protection Act* ("Dodd-Frank") into law. Public Law No. 111-203. Dodd-Frank substantially revises many federal financial services and securities laws. Effective July 21, 2011, Dodd-Frank eliminates the existing "private adviser" exemption set forth in Section 203(b)(3) of the Investment Adviser Act of 1940 ("1940 Act").

Section 203(b)(3) exempts from federal registration any investment adviser who has fewer than fifteen clients and who neither holds itself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company. Advisers to alternative investment vehicles such as hedge funds, private-equity funds, and venture capital funds frequently rely on the Section 203(b)(3) exemption from registration.

As a replacement to the "private adviser" exemption, Dodd-Frank creates a new regulatory regime for advisers to "private funds." The term "private funds" refers to investment funds that would be required to register under the Investment Company Act of 1940, but for Section 3(c)(1) or 3(c)(7) of that act. Persons who exclusively advise private funds, are exempt from registration with the Securities and Exchange Commission ("SEC") if they (1) advise venture capital funds, or (2) manage less than \$150 million of assets.

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In California, investment advisers currently exempt under Section 203(b)(3) of the 1940 Act have a corollary exemption under California investment adviser licensing requirements, if they meet the requirements of Section 260.204.9 of Title 10 of the California Code of Regulations, and (1) have assets under management of not less than \$25,000,000, or (2) exclusively advise “venture capital companies,” as that term is defined in the rule.

As a result of Dodd-Frank, on July 21, 2011, Section 260.204.9 will no longer provide an exemption from California licensing requirements. In anticipation of these changes, the California Corporations Commissioner will be amending Section 260.204.9 to reflect the changes in the corresponding federal rules. The Commissioner seeks input on the issue of how best to regulate advisers to alternative investment vehicles, while balancing the regulatory burden on such advisers, with any corresponding investor protections issues.

INVITATION

In accordance with Government Code Section 11346(b), the Department seeks to involve parties who would be subject to the regulations and other interested parties in discussions regarding the proposed regulations. The Commissioner invites interested parties to review the accompanying draft text of a proposed regulatory structure for advisers to alternative investment vehicles, and provide comments.

In addition, the Commissioner invites interested parties to consider the following questions:

1. To avoid the “retailization” of private alternative investment funds, should the exemption apply exclusively to advisers to Section 3(c)(7) funds (i.e., not to Section 3(c)(1) funds)?
2. Should all persons investing in a Section 3(c)(1) fund be required to be qualified clients? If so, should the Department issue an order that “grandfathers” Section 3(c)(1) funds organized prior to July 21, 2010?
3. Should the proposed statutory disqualification provisions be expanded to include additional factors?
4. Should the proposed asset under management threshold (AUM) be a different amount than that set forth in the proposed rule (i.e. \$100 million)? If so, what is the basis for a different threshold?
5. Are there criteria other than AUM that the Commissioner should consider to determine whether an adviser should be exempt (e.g., the fund is subject to an annual audit)?

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6. Should the Department's definition of venture capital company/fund conform to the proposed SEC definition?

7. Should the Department adopt the North American Securities Administrators Association (NASAA) proposed model rule for an exemption for Private Fund Advisers?

TIME FOR COMMENTS

Accordingly, the Department is providing the attached text of draft regulations to interested parties, and invites interested parties to submit comments on these documents by March 28, 2011. Comments from interested persons will assist the Department in determining whether amendments to regulations under the Corporate Securities Law are necessary and appropriate.

This solicitation for comments from interested parties is not a proposed rulemaking action under Government Code Section 11346, and the public will have an additional opportunity to comment on proposed changes if, after consideration of the comments from interested parties, the Department proceeds with a notice of a proposed rulemaking action.

WHERE TO SUBMIT COMMENTS

You may submit comments by any of the following means:

Electronic

Comments may be submitted electronically to regulations@corp.ca.gov. Please identify the comments as PRO 02/11.

Mail

California Department of Corporations
Office of Legislation and Policy
Attn: Karen Fong (PRO 02/11)
1515 K St., Suite 200
Sacramento, CA 95814

Fax

(916) 322-5875

CONTACT PERSON

Questions regarding this invitation for comments may be directed to Ivan V. Griswold, Corporations Counsel, at (415) 972-8937 or igriswo@corp.ca.gov.